86-1003 C
UT ARLINGTON LIBRARIES
3 1334 00692 3771

Annual Report 1986

UNIVERSITY OF TEXAS AT ARLINGTON LIBRARY
SHELVED IN B-SS DIV.

Dayton Hudson Corporation

Corporate Profile

Dayton Hudson Corporation is a growth company focusing exclusively on retailing. At year-end, the Corporation operated 475 stores in 34 states. ■ Dayton Hudson's principal operating strategy is to provide exceptional value to the American consumer through multiple retail formats. Retail operations are conducted by four business segments.

■ Target is an upscale discount store chain operating in 22 states. Target offers low prices on a broad assortment of high-quality fashion and basic hardlines and softgoods in easy-to-shop, self-service stores.

■ Mervyn's is a highly promotional, popular-priced, value-oriented department store company operating in 12 states. Mervyn's stores feature nationally branded and private-label apparel, accessories and household softgoods.

■ The Dayton Hudson Department Store Company (DHDSC) emphasizes fashion leadership, quality merchandise, broad selections and customer service. It operates Hudson's and Dayton's stores in seven states.

■ Lechmere is a hardlines retail company operating in six states. Lechmere stores offer products from four distinct worlds of merchandise: consumer electronics, major appliances, housewares and leisure-time equipment.

Target, Mervyn's, Dayton's, Hudson's and Lechmere are federally registered marks of Dayton Hudson Corporation. Greatland and Sostanza are trademarks of Dayton Hudson Corporation.

CONTENTS

Letter to Shareholders	2
Target	4
Mervyn's	6
Dayton Hudson Department Store Company	8
Lechmere	10
Financial Information	12
Stores and Locations	28
Directors and Management	29

Corporate Information

Corporate Offices

777 Nicollet Mall, Minneapolis, Minnesota 55402
Telephone: (612) 370-6948

Annual Meeting

The Annual Meeting of Shareholders is scheduled for 9:30 a.m. Wednesday, May 27, 1987, at The Children's Theatre, Minneapolis Institute of Arts, 2400 Third Avenue South, Minneapolis, Minnesota.

Community Involvement

In keeping with its commitment to corporate responsibility, Dayton Hudson annually contributes an amount equal to 5% of its federally taxable income to support its giving programs. For a complete report on 1986 contributions and programs, write to Vice President, External Affairs at the Dayton Hudson corporate offices.

10-K Report

A copy of the Form 10-K annual report filed with the Securities and Exchange Commission for Dayton Hudson's fiscal year ended January 31, 1987, is available at no charge to shareholders. Write to Director, Financial Relations at the Dayton Hudson corporate offices.

Dividend Reinvestment Plan

The dividend reinvestment plan is a convenient way for Dayton Hudson shareholders to acquire additional shares of the Corporation's common stock through automatic dividend reinvestment and voluntary cash purchase. All holders of Dayton Hudson common stock may participate. For more information, write to Morgan Shareholder Services Trust Company, P.O. Box 3506, New York, New York 10008-3506.

Transfer Agent, Registrar and Dividend Disbursing Agent

Morgan Shareholder Services Trust Company

Trustees

First Trust Company, Inc.
First National Bank of St. Paul

Stock Exchange Listings

New York Stock Exchange
Pacific Stock Exchange
(Trading Symbol DH)

Shareholder Assistance

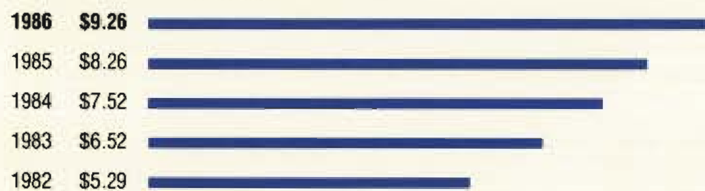
For assistance regarding individual stock records and transactions, contact Shareholder Relations at the Dayton Hudson corporate offices or Morgan Shareholder Services Trust Company, P.O. Box 3981, New York, New York 10008-3981. Information Center telephone: (212) 587-6515.

Financial Highlights

Continuing Operations

(Millions of Dollars, Except Per-Share Data)	1986	1985	Percent Increase (Decrease)
For the Year:			
Revenues	**$9,259.1**	$8,255.3	12%
Earnings before income taxes and extraordinary charge	**494.2**	517.8	(5)
Income taxes	**239.2**	237.3	1
Net earnings before extraordinary charge	**255.0**	280.5	(9)
Net earnings per share before extraordinary charge	**2.62**	2.89	(9)
Cash dividend paid per share	**.84**	.76	11
At Year-End:			
Shares outstanding	**97,368,703**	97,196,263	
Number of shareholders	**15,480**	15,022	
Retail square feet	**47,672,000**	43,205,000	
Number of stores	**475**	421	

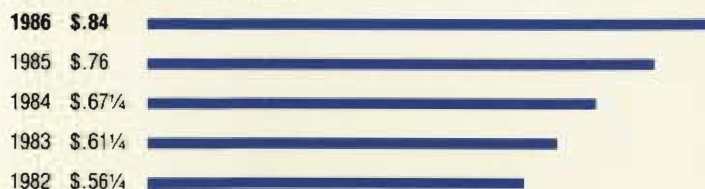
REVENUES (Billions of Dollars)



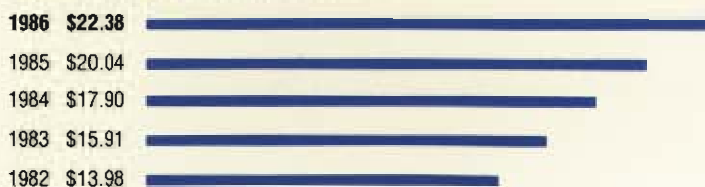
NET EARNINGS PER SHARE*

*Continuing operations before extraordinary charge.

CASH DIVIDEND PAID PER SHARE



SHAREHOLDERS' INVESTMENT PER SHARE



The Year in Review

- Total revenues from continuing operations increased 12% to top the $9 billion mark. Comparable-store revenues–from stores open longer than 12 months–rose 5%.
- Operating profit was approximately equal to a year ago. Target and the Dayton Hudson Department Store Company reported increases, while Mervyn's operating profit declined. Lechmere's operating profit was approximately equal to last year.
- Net earnings per share from continuing operations of $2.62 were down 9% from a year ago.
- The loss of investment tax credit under the Tax Reform Act of 1986 reduced net earnings by 11 cents per share.
- Consolidated net earnings per share were $3.19 after a one-time gain from the sale of B. Dalton and an extraordinary charge.
- We added 21 Target stores, 27 Mervyn's stores and seven Lechmere stores. Branden's, our home furnishings test strategy, opened one store.
- Total capital investment included the acquisition of 50 real estate sites which will be remodeled and opened as Target stores in 1987 to further strengthen our West Coast presence.
- A major debt restructuring program involving the issuance of $1 billion of debt and the purchase and redemption of approximately $560 million of our high-interest rate debt was completed. The replacement of this debt will result in substantial savings in interest expense in future years.
- We sold B. Dalton Bookseller because it no longer fit within the strategic direction of the Corporation.
- We invested more than $20 million in the communities where we do business. Giving programs were focused in two areas: social action and the arts.
- Boake A. Sells, President of Dayton Hudson, was named President and Chief Operating Officer.
- Gerald R. Gallagher resigned as Chief Administrative Officer and as a director.
- The Board of Directors added two new members: Betty Ruth Hollander, Chairman and Chief Executive Officer of The Omega Group, Inc., and David T. Kearns, Chairman and Chief Executive Officer of Xerox Corporation.

1-31-86

UNIVERSITY OF TEXAS AT ARLINGTON LIBRARY

To Our Shareholders:

As a company with a strong record of performance and a firm commitment to growth, it is disappointing for us to report a decline in earnings for 1986. ▪ Three of our retail companies performed very well during the year. Target and the Dayton Hudson Department Store Company reported excellent results. We are also pleased with the results achieved by Lechmere in a year of major expansion. The one exception in our performance was Mervyn's, which reported a substantial decline in operating profit. ▪ While we are not satisfied with our performance in 1986, we are encouraged by the progress made during the year from a strategic perspective. The near-term effect of some of our decisions may have been painful and costly, but we are confident that, over time, they will strengthen our competitive position. ▪ Mervyn's is a case in point. Mervyn's fell short of its usually strong performance because the company chose to address some very difficult issues in 1986. Some of these issues, like organizational restructuring, had a disruptive effect on the day-to-day management of the business during much of the year. At the same time, however, we are already beginning to see some positive benefits in the form of a lower expense structure and a management organization that is closer to the customer. ▪ Similarly, an aggressive program to lower prices which reduced gross margin also hurt Mervyn's 1986 earnings, but will ultimately result in a much stronger, more competitive company in the future. ▪ For Target, 1986 was a year of both record performance and strategic significance. Target undertook the most important real estate transaction in its history with a major acquisition of existing stores on the West Coast. As Target opens 50 of these stores in 1987, it will enter two very important new markets: the San Francisco Bay area and the Central Valley of California. The acquisition also will add significantly to Target's already strong presence in Southern California. ▪ Record performance by the Dayton Hudson Department Store Company in 1986 reflects strong trend merchandising, excellent customer service and innovative marketing. DHDSC is also realizing some very positive benefits from the combination of Dayton's and Hudson's, a strategic action undertaken three years ago. ▪ The year 1986 was one of dramatic growth for Lechmere. Seven new units brought total stores at year-end to 17. The expansion included four stores in Atlanta, Lechmere's first venture outside of New England. ▪ Two other major developments took place in 1986. We sold B. Dalton Bookseller because it no longer fit within the strategic direction of the corporation. And we undertook a major debt restructuring program that will result in substantial savings in interest expense in the

Left: Kenneth A. Macke, Chairman of the Board and Chief Executive Officer.
Right: Boake A. Sells, President and Chief Operating Officer.

years ahead. ▪ As we review our progress and performance for 1986, we believe one thing is very clear: this management team is committed to long-term growth. We remain convinced that the decisions made and the actions taken during the past year are in the best interests of our shareholders. We are confident that this will become evident in 1987 and beyond. ▪ We are optimistic about the prospects for Dayton Hudson. We have the strategies in place to continue our growth and we have the people to make those strategies work. Our management team is experienced, firmly committed to performance and backed by strong people throughout the entire Corporation. ▪ Most importantly, we recognize that we are in business for one purpose: to serve our customers. This clear sense of direction has served us well in the past and will continue to guide our growth in the future as our companies work even harder to provide excellent service to their customers. ▪ We encourage you to read the review of our business segment operations on the following pages. We believe that you will share the excitement and optimism we have about the future of Dayton Hudson Corporation.

April 3, 1987

Kenneth A. Macke
Chairman of the Board and
Chief Executive Officer

Boake A. Sells
President and
Chief Operating Officer

Target

1986 OPERATING HIGHLIGHTS

- **Revenues increased 11% to top $4 billion.**
- **Comparable-store revenues rose 5%.**
- **Operating profit increased 12%.**
- **Improved operating expenses offset slightly lower gross margin.**
- **Twenty-one new stores opened; total stores increased to 246.**
- **Major West Coast real estate acquisition negotiated.**

(Millions of Dollars)	1986	1985	1984
Revenues	**$4,354.9**	$3,931.5	$3,550.1
Operating Profit*	**$ 311.0**	$ 277.8	$ 235.6
Stores	**246**	226	215
Retail Square Feet (000)**	**24,260**	22,414	21,071

*Operating profit is LIFO earnings from operations before corporate expense, interest and income taxes.
**Total square feet less office, warehouse and vacant space.

ecord Results, Continued Growth Mark 1986 For Target

Target continued its consistent pattern of record performance and rapid expansion in 1986. ■ Revenues increased 11% to top the $4 billion mark. Comparable-store revenues rose 5%. ■ Operating profit rose 12%. An improvement in the operating expense rate offset a slightly lower gross margin rate which resulted from Target's continuing strategy to lower its everyday prices. ■ Target opened 21 new stores in 1986. Among the additions were five units in the Los Angeles area, which brought total stores there to 30 at year-end. ■ Near the end of the year, Target negotiated a major real estate transaction in California which will provide an entry into some important new markets and strengthen the company's presence in key existing markets. Fifty of the stores will be remodeled and opened in the second half of 1987.

Target's Private Labels Deliver Quality, Value

Merchandise bearing private labels has accounted for a growing percentage of Target's sales in recent years. That share is likely to grow even larger as the offering is strengthened with additional labels to supplement successful existing labels. ■ Target's private label merchandise programs are designed to appeal to specific customer lifestyles and attitudes. The *Greatland* label, for example, is found on outdoors apparel, boots, backpacks and all-terrain bicycles. *Sostanza* appeals to the shopper looking for the newest fashion trends in apparel, accessories and jewelry. ■ During 1987 Target will include hardlines products such as stationery and home furnishings in its private label merchandise program.

Major Growth Expected in Products for Children

With the birth rate at its highest level in more than 20 years, America is experiencing a baby boom "echo." As a result, there are now more than 34 million children under the age of 10. ■ Target is responding to this major demographic trend by expanding its assortments of merchandise geared to the needs and wants of today's children. ■ Placemats, drinkware and dinnerware for children are best-selling items in the tabletop category. Other key juvenile products in the home area include brightly colored furniture, bed linens, curtains, pictures and pillow people. ■ Among Target's most popular toys are high-tech electronic plush animals, two-wheeled scooters and "skoot-skates," skateboards with handlebars.

Taking Care of Customers is Target's Top Priority

Target made significant progress in improving customer service in 1986, with much of the effort focused on helping shoppers move more quickly through the checkout lanes. ■ The introduction of scanning, following a successful test in 1986, will result in much faster checkouts and greater accuracy. Plans call for scanning to be added in more than 90 stores in 1987, including all of the new California stores. By year-end, about 110 Target stores will have the system. Completion of the project is expected by early 1989. ■ Target is also using a portable scanner in all stores to reduce the time involved in looking up prices on unticketed merchandise at the checkout lane. ■ As part of an overall effort to increase in-store assistance, all stores now have an employee at the entrance to the checkout lanes to answer inquiries and direct customers to the shortest lines.

Fifth Distribution Center Opened

Target opened its fifth major regional distribution center in 1986, a 550,000 square-foot facility in Pueblo, Colorado. The new center is shipping merchandise to Target stores in Wyoming, South Dakota, Montana, Arizona and Colorado. ■ The new facility, which will service approximately 50 stores, has the latest distribution technology, including a computerized system that can sort up to 110 cartons of merchandise per minute. ■ The Pueblo center also will support Target's other regional distribution centers in Minneapolis, Little Rock, Indianapolis and Los Angeles.

1987: A Year of Dramatic Growth

In the largest single-year expansion in its history, Target will open 74 stores in 1987. ■ The expansion includes 50 units, primarily in California, that will open in stores acquired in the 1986 real estate transaction. Among these are 12 stores in the San Francisco Bay area as well as others in key Central Valley markets that will expand Target's presence throughout California. An additional 23 stores in the Los Angeles area will bring total units there to 53. ■ Other new-market entries planned for 1987 include metropolitan Detroit with six stores and Las Vegas with three stores.

1986 OPERATING HIGHLIGHTS

- **Revenues increased 13% to $2.9 billion.**
- **Comparable-store revenues increased 4%.**
- **Operating profit declined 35%, reflecting a substantial reduction in gross margin.**
- **Organizational restructuring resulted in improved operating expenses.**
- **Record 27 stores opened; new markets included Atlanta, Denver, Tulsa.**

(Millions of Dollars)	1986	1985	1984
Revenues	**$2,862.3**	$2,527.0	$2,141.1
Operating Profit	**$ 160.2**	$ 245.0	$ 223.3
Stores	**175**	148	126
Retail Square Feet (000)	**13,839**	11,733	9,989

A Year of Change for Mervyn's

For Mervyn's, 1986 was a year of organizational change. While many of the changes were difficult and challenging, they will strengthen Mervyn's competitive position significantly in the future. ■ Organizational restructuring during the year had a major disruptive effect on day-to-day business. During 1986, Mervyn's closed its South Central headquarters and relocated the Dallas-based merchandising, sales promotion and support functions to its company headquarters in Hayward, California. These changes, together with a restructuring of the headquarters organization, resulted in an improved operating expense rate. ■ Mervyn's revenues increased 13% in 1986. Comparable-store revenues were up 4%. ■ Operating profit for the year declined 35%, reflecting a substantial reduction in the company's gross margin rate resulting from higher markdowns and an aggressive program to lower everyday prices. ■ Mervyn's opened a record 27 stores in 1986, including units in three new markets: Atlanta, Denver and Tulsa.

A Focus on Merchandising

One of Mervyn's primary objectives for 1987 is to refine its merchandising strategy by improving the content of its merchandise offering. ■ One goal of the effort is improved trend merchandising. Mervyn's merchants are working to stay on top of the trends and interpret them for the customer. A move to narrower assortments will enable customers to identify trends more easily. ■ Mervyn's also is focusing on quality control to ensure greater consistency in its private label merchandise. ■ Another key objective for Mervyn's in 1987 is to provide greater consistency in its in-stock position for both promotional and basic merchandise. ■ Mervyn's is continuing to review its pricing strategy to ensure that it is providing its customers the greatest value in the marketplace.

Communicating Mervyn's to the Customer

As Mervyn's refines its merchandising direction in 1987, it is analyzing its sales promotion strategy to ensure that fashion trends are communicated to the customer. ■ Mervyn's advertising tabloid is being redesigned to present trend merchandising stories more effectively. The tabloid appears each week in nearly 200 newspapers, reaching shoppers throughout all of Mervyn's markets. ■ A new television advertising campaign also will debut in 1987.

New Store Prototype to be Tested

Mervyn's is developing a new store prototype which will be tested in 1987. ■ In designing the prototype, Mervyn's is looking at the entire shopping cycle, from the customer's entry into the store, to product selection, to final purchase. The objective of the new design is to make the entire

process easier and more convenient for Mervyn's customers. ■ To achieve this objective, Mervyn's store planners are aiming for a better integration of visual merchandising, presentation and interior design. ■ The new prototype also will have improved merchandise layouts, aisle patterns and department adjacencies and sizes.

Computerized Technology Speeds Checkout

Mervyn's is responding to the customer's demand for convenient shopping with computerized technology that simplifies and speeds the checkout process. ■ During 1986 automatic full price look-up was installed in all stores. The computerized system, which returns an item's price within one to two seconds, reduces checkout transaction time by 15%. ■ Electronic check clearance, also introduced to all stores in 1986, speeds the checkout process by reducing the wait for check approval. A similar computerized system authorizes bankcard credit transactions. ■ During 1987, Mervyn's will test a magnetic stripe reading system that automatically reads the information on credit cards. Mervyn's also will begin testing the implementation of scanning.

1987 Expansion Includes Michigan Entry

Among the 24 new Mervyn's stores scheduled to open in 1987 are the company's first units in Michigan. Six stores in metropolitan Detroit and two in Lansing will be the first of as many as 30 units planned for Michigan over the next five years. ■ Additional openings planned for 1987 include four stores in the Los Angeles area, which will increase total operations there to 36 stores. Other additions to existing markets include one store in Colorado and one in Atlanta. ■ At year-end, Mervyn's will be operating 199 stores in 13 states.

Dayton Hudson Department Store Company

1986 OPERATING HIGHLIGHTS

- **Revenues rose 8% to $1.57 billion; operating profit increased a strong 36%.**
- **Gross margin and operating expenses improved.**
- **Results reflect efficiencies from combination of Dayton's and Hudson's.**
- **Major trend merchandising successes with strong statements in denim and fleece.**
- **More than one million Santabears sold during the holiday season.**

(Millions of Dollars)	1986	1985	1984
Revenues	**$1,566.3**	$1,447.9	$1,396.3
Operating Profit	**$ 165.8**	$ 121.8	$ 106.7*
Stores	**37**	37	36
Retail Square Feet (000)	**7,791**	7,904	7,896

*Results from Diamond's and John A. Brown included through September 29, 1984.

Strong Merchandising, Operating Efficiencies Bring Record Results for DHDSC

By all measures, 1986 was an excellent year for DHDSC. The company posted record revenues and operating profit, reflecting both strong results from day-to-day merchandising and efficiencies resulting from the combination of Dayton's and Hudson's. ■ Operating profit was up 36% on the strength of sharp improvement in the gross margin rate. The operating expense rate also improved over a year ago. ■ Revenues for the year advanced 8% to $1.57 billion. ■ Excellent trend merchandising was responsible for a large part of DHDSC's improved results for 1986. The company achieved major success with strong statements in trends like denim and fleece. ■ The Christmas Santabear promotion again achieved dramatic success with more than one million Santabears sold during the holiday season. Sales of more than 120 related items also were strong.

Trend Merchandising, Superior Service Keys to DHDSC Mission

DHDSC believes that well-executed trend merchandising and superior customer service are the keys to achieving its mission to profitably expand market share. ■ DHDSC's trend merchandising strategy is aimed at making its merchandise offering different from that of key competitors. The objective is to take full advantage of being first with a trend to maximize its sales potential. ■ Superior customer service also gives DHDSC something customers cannot find in other stores. Service begins with warm, friendly and knowledgeable sales personnel who are sincerely interested in helping customers solve their shopping problems. It also includes an offering of merchandise and services that meets customer needs and a shopping environment that is convenient and efficient.

"Performance Plus" Aims for Improved Customer Service

As part of its ongoing commitment to the customer, DHDSC is testing an exciting and dramatic new customer service program. ■ Entitled "Performance Plus," the program sets higher standards for customer service, restructures the store organization and compensation system and reinforces DHDSC history and culture among all employees. ■ Under the program, employee performance standards and job descriptions are being redefined to hold everyone responsible for improving customer service. The objective is to make superior customer service the primary reason for every decision made by every employee.

Making the Store More Convenient for the Customer

Today's active lifestyles leave little time for shopping. When customers do shop, they demand an

efficient and convenient environment that allows them to make the best use of their time. ■ DHDSC is looking closely at all aspects of store operations to make shopping easier for its customers. Among the areas targeted for greater efficiency and convenience are the fitting rooms, aisle configurations, fixtures and signs. ■ One area that is receiving especially close attention is the way merchandise is organized and presented to the customer. DHDSC is working to consolidate similar merchandise into fewer departments so customers can make their selections more efficiently. ■ Convenient services such as package pick-up are also being introduced in every store.

Holiday Promotions Bring Competitive Edge, Added Sales

DHDSC is taking a unique marketing approach to holidays that is giving it a distinct edge over the competition. ■ The approach combines marketing, merchandising and special events to remind customers of the holidays and let them know that Dayton's and Hudson's stores feature many unique and fun items that are ideal for holiday gift giving. ■ A key element in the strategy is the purchase-with-purchase promotion that enables customers to buy a gift item at a special price if they purchase a certain amount of merchandise. The concept, which began with Santabear, was expanded in 1986 to include such gift items as a Father's Day Dad's® root beer mug and a "Hi, Mom!" coffee mug for Mother's Day.

Remodeling for Improved Merchandising, Service

A substantial portion of the capital investment planned by DHDSC over the next five years is earmarked for major store remodeling. These projects range in scope from remodeling total stores such as Dayton's flagship store in Minneapolis, to individual department makeovers like accessories expansion taking place in several Dayton's and Hudson's stores. ■ In each case, the objective is to create an updated shopping environment that lends itself to dominant presentations and effective trend merchandising. The projects also aim for improved customer service by making shopping easier through redesigned merchandise department adjacencies. ■ Major remodeling projects are scheduled for 10 Hudson's stores and 3 Dayton's stores in 1987— the most the company has undertaken in a single year.

Lechmere

1986 OPERATING HIGHLIGHTS

- **Revenues rose 36% to $476 million.**
- **Comparable-store revenues rose 4%.**
- **Operating profit was approximately equal to a year ago despite planned expansion expenses.**
- **Seven new stores added; total stores at year-end numbered 17.**
- **Four stores in Atlanta mark first expansion outside of New England.**

(Millions of Dollars)	1986	1985	1984
Revenues	**$475.6**	$348.9	$280.2
Operating Profit	**$ 19.5**	$ 19.8	$ 20.2
Stores	**17**	10	8
Retail Square Feet (000)	**1,782**	1,154	971

Growth for Lechmere in 1986

Seven new Lechmere stores opened during the year, bringing total units at year-end to 17. ■ Among the 1986 openings were four stores in Atlanta, marking Lechmere's first expansion outside New England. Other openings during the year included stores in Nashua, New Hampshire, Weymouth, Massachusetts, and Hartford, Connecticut. Revenues in 1986 rose 36% to reach $476 million. Comparable-store revenues increased 4%. ■ Operating profit was approximately equal to a year ago even with planned expenses associated with expansion.

Four Merchandise Worlds Define Lechmere Offering

Four distinct worlds of merchandise bring a balanced offering of hardlines products to the Lechmere shopper. ■ Lechmere's consumer electronics department features the latest and most sophisticated televisions, VCRs, camcorders, stereo components, car stereos and compact disc players. Electronics products for business or home office include personal computers, telephones, answering machines, typewriters and copiers. ■ A broad selection of name-brand refrigerators, ranges, dishwashers, microwave ovens, washers and dryers forms Lechmere's offering of major appliances. ■ Products in the housewares category include kitchen utensils, tableware, cookware and cutlery. The offering also features small appliances, personal care items and kitchen appliances. ■ Leisure-time equipment offered at Lechmere includes home gym sets, bicycles, golf clubs, camping equipment, rowing machines, grills, hardware and tools and athletic footwear. ■ Within each of these worlds, Lechmere's goal is to be recognized by customers as having the best overall everyday values.

Lechmere Stores are "Customer Friendly"

Using data from extensive surveys which show that consumers today demand convenient, easy-to-shop stores, Lechmere has created what it calls a "customer-friendly" shopping environment. ■ Lechmere stores are designed so that virtually every merchandise category is visible from the store's main entrance. Merchandise is displayed in a unique hands-on setting that allows customers to ride an exercise bike, try out a home computer, listen to stereo equipment or operate a video camera. ■ Departments are staffed by well-trained and knowledgeable sales personnel who can answer questions and provide assistance if necessary. ■ Merchandise can be selected at the display site and taken to a checkout for purchase. For larger items, product information is entered into a computerized stock system which then signals the pick-up area to have the merchandise waiting for customers after they have finished at the checkout.

Strong Growth Expected in Merchandise for Home and Family

As the home continues to grow in importance as a center for family entertainment, Lechmere is looking for significant growth in sales of merchandise geared to home and family life. ■ Within the leisure category, backyard sports equipment such as horseshoes and croquet, badminton and volleyball sets are showing strong sales. Bicycles and scooters also are very popular. ■ Products for family entertaining like ice-cream makers, popcorn poppers, and pre-recorded video movies are expected to continue to experience major growth. ■ Among the most popular products for family entertainment in the electronics category is the electronic piano keyboard. Total unit sales of the 12 different models offered by Lechmere topped 25,000 in 1986. Continued growth is expected as more sophisticated models are added to the offering.

Lechmere Expands Athletic Footwear Business

As more and more people begin to use athletic shoes for both exercise and for all-purpose footwear, Lechmere is responding with broader assortments of the styles and brand names that its customers want most. ■ Lechmere's athletic footwear business experienced dramatic growth in 1986, following an expansion of assortments to include more than 200 styles and conversion to a self-service format. ■ Soft leather aerobic shoes and tennis shoes in a variety of colors are the category's bestsellers. ■ Lechmere is also adding more walking shoes to its offering in response to the growing popularity of walking as a form of exercise.

New Market Entries Highlight 1987 Expansion

Lechmere's 1987 expansion plans call for six new stores. The additions, which include five stores in new markets, will bring total units at year-end to 23 in eight states. ■ Lechmere will continue to expand in the Northeast, opening two stores in Rochester, New York, and single units in Poughkeepsie, New York, and Worcester, Massachusetts. The Worcester store will increase total units in the Boston area to seven. ■ In the Southeast, Lechmere will open its first Florida store in Clearwater. A new unit in Raleigh will mark Lechmere's entry into North Carolina.

Financial Review of Continuing Operations

(Millions of Dollars, Except Per-Share Data)

Our objective is to provide our shareholders with a superior return on their investment through a combination of stock price appreciation and current income, while maintaining a flexible and conservative capital structure.

Performance Objectives

Our financial performance objectives are based upon a long-term perspective of superior performance. We review our objectives annually in light of changes in the competitive environment, equity investor opportunities and the rate of inflation.

Our current objectives are to:

- Earn an after-tax return on beginning shareholders' equity (ROE) of 18%. Our return on equity was 13.1% in 1986, 16.2% in 1985 and 15.9% in 1984.
- Sustain an annual growth in earnings per share (EPS) of 15%. EPS from continuing operations declined 9% in 1986, compared with an increase of 14% in 1985 and 8% in 1984. Over the past five years, earnings from continuing operations have grown at a compound annual rate of 12%.
- Maintain a strong rating of our senior debt. Our long-term debt is rated in the AA category by Standard and Poor's and Moody's and its equivalent by Duff and Phelps. Our commercial paper is rated P-1 by Moody's and A-1 + by Standard and Poor's.

We believe that achievement of our financial performance objectives depends largely upon our ability to produce a superior return on investment (ROI).

We believe ROI is the most important single measure of financial performance and it is the primary financial tool we use to manage our business. We define ROI as the after-tax return on investment before borrowing costs. The following table shows the calculation of ROI for the past three years.

	1986	1985	1984
Net earnings from continuing operations	**$ 255.0**	$ 280.5	$ 245.6
Interest expense—after tax (a)	**55.9**	49.9	49.7
Interest equivalent in leases—after tax (b)	**16.8**	14.7	15.6
Earnings before financing costs	**$ 327.7**	$ 345.1	$ 310.9
Working capital (c)	**$1,104.3**	$ 943.4	$ 866.0
Net property and equipment	**1,655.7**	1,418.6	1,306.8
Other non-current assets	**22.3**	13.0	14.7
Capital leases	**114.7**	114.7	115.8
Present value of operating leases	**258.1**	230.0	257.1
Total investment at beginning of year	**$3,155.1**	$2,719.7	$2,560.4
Return on investment	**10.4%**	12.7%	12.1%

(a) Interest expense on beginning-of-year debt and capital leases.
(b) Assumes after-tax interest cost of approximately 6% on beginning-of-year present value of operating leases.
(c) Current assets less non-interest bearing current liabilities.

ROI is an important part of the following management processes:
Performance Appraisal. The incentive compensation of corporate management and the management of each operating company is based on return on investment, as well as on growth in earnings.

			1986	1985	1984	Description of Ratios:
Return on Sales	=	Earnings / Sales	**3.6%**	4.2%	4.2%	Return on sales indicates the amount of profit per dollar of sales before financing costs.
times						
Investment Turnover	=	Sales / Investment	**2.9x**	3.0x	2.9x	Investment turnover provides a measure of the sales generated from each dollar invested in our business.
equals						
Return on Investment	=	Earnings / Investment	**10.4%**	12.7%	12.1%	Return on investment provides a measure of profit generated from total dollars invested before financing costs.
Return on Equity	=	Net Earnings / Equity	**13.1%**	16.2%	15.9%	Return on equity provides a measure of profit generated per dollar of shareholder investment.

Investment and equity are beginning of period.

Capital Allocation. We allocate capital for expansion of an operating company based on its actual and projected performance measured against its ROI standard. Additional criteria for allocating capital include the quality of the company's strategic plan, strength of the management team, systems and development of market position.

Capital Project Evaluation. Store projects are expected to achieve ROI levels which will produce an internal rate of return over their life of 13%. The internal rate of return measure is designed to provide a profit on incremental investment above our cost of capital. We audit actual results in the years following completion to determine actual individual project performance.

Financial Policies

Consistent with our objective of maintaining a strong rating on our senior debt, we have established a maximum debt ratio of 45% of total capitalization, including capital leases and the present value of operating leases. Despite our expansion program, our debt ratio has remained below 45%.

Capitalization	**1986**	1985	1984
Long-term debt (a)	**$1,250.5**	$ 814.2	$ 631.1
Capital leases (a)	**136.7**	133.2	129.9
Present value of operating leases	**382.2**	258.1	230.0
Total debt and equivalent	**1,769.4**	1,205.5	991.0
Deferred items	**301.4**	121.4	98.9
Equity	**2,179.5**	1,947.4	1,736.5
Total capitalization	**$4,250.3**	$3,274.3	$2,826.4
Debt ratio (total debt and equivalent as a percentage of total capitalization)	**42%**	37%	35%

(a) Including current portion.

The major portion of our growth will continue to be financed with internally generated funds. The remainder will be financed with a mix of intermediate-term and long-term debt which is consistent with the cash flow characteristics of our capital investments. Commercial paper will continue to be used primarily to fund seasonal working capital requirements.

Because of the lead times required for planning and construction of our stores, we make commitments for some of our capital projects before actual capital expenditures occur. Our financial policies limit the amount of these forward commitments to a level which could be funded by projected internally generated funds.

Capital Investment

Target and Mervyn's are receiving the majority of our capital investment allocation. Capital investment in 1986 totaled $1,089 million, including the present value of all new leases.

Capital Investment	**1986**	1985	1984
Capital expenditures	**$ 941**	$403	$336
Present value of new operating leases	**148**	41	14
Total	**$1,089**	$444	$350

Capital investment in 1987 is expected to total more than $800 million. For the 1987-1991 period, current plans anticipate capital investment of approximately $5 billion.

Dividends and Common Stock Price Per Share

In support of our objective to provide our shareholders with a superior return on their investment, it is our policy to make regular annual increases in dividends on common stock.

Dividends declared in 1986 totaled $.86 per share, a 10% increase over the $.78½ per share declared in 1985. The quarterly dividend was increased to $.23 per share for the dividend declared in the fourth quarter. The current annualized rate is $.92 per share.

Dayton Hudson Corporation Common Stock is listed on the New York Stock Exchange and the Pacific Stock Exchange with the symbol DH, and abbreviated in newspaper listings as DaytHd. At year-end 1986, the number of Dayton Hudson shareholders of record was 15,480, compared with 15,022 at year-end 1985. On April 3, 1987 there were 15,592 shareholders of record and the common stock price was $45⅝.

	Quarterly Dividend Declared Per Share		Common Stock Price Range			
Fiscal			**1986**		1985	
Quarter	**1986**	1985	**High**	**Low**	High	Low
First	**$ .21**	$.18½	**$55⅞**	**$40⅜**	$40¾	$35¼
Second	**.21**	.18½	**58½**	**44¼**	45¼	38
Third	**.21**	.20½	**48⅛**	**40**	41¼	36½
Fourth	**.23**	.21	**47¾**	**40¾**	48¾	38⅞
Total Year	**$ .86**	$.78½	**$58½**	**$40**	$48¾	$35¼

Analysis of Continuing Operations

(Millions of Dollars, Except Per-Share Data)

Revenues increased 12% in 1986 due to expansion and moderate growth in comparable-store revenues (revenues from stores open longer than 12 months). Our performance follows a revenue increase of 10% in 1985. Net earnings from continuing operations before an extraordinary charge declined 9%. The decline is the result of a substantial reduction in Mervyn's gross margin rate. Our earnings decline follows an earnings increase of 14% in 1985.

Our financial statements and related information for 1986 and all prior years have been restated to exclude B. Dalton from continuing operations. B. Dalton was sold effective December 27, 1986.

The following table illustrates the impact of the major factors contributing to the changes in our operations since 1984.

Variance analysis:	**1986 vs. 1985**	1985 vs. 1984
Prior year's earnings per share	**$2.89**	$2.54
Change in earnings per share due to:		
Revenues	**.39**	.27
Gross margin rate	**(.71)**	.12
Operating expense rate	**.33**	.06
Start-up expenses	**(.06)**	(.02)
Interest expense, net	**(.10)**	(.01)
Income tax rate	**(.13)**	—
Corporate expense and other factors, net	**.01**	(.07)
Earnings per share	**$2.62**	$2.89

Revenues

The major portion of our revenue growth continues to be generated by Target and Mervyn's, primarily due to their aggressive expansion over the last few years. Lechmere's significant revenue growth was also due to expansion. Each of our business segments also reported increases in comparable-store revenues.

Revenue Increases	**1986**		1985		1984*	
	All Stores	**Comparable Stores**	All Stores	Comparable Stores	All Stores	Comparable Stores
Target	**11%**	**5%**	11%	6%	14%	7%
Mervyn's	**13**	**4**	18	8	27	11
DHDSC	**8**	**8**	4	4	12	12
Lechmere	**36**	**4**	25	8	23	14
Total	**12%**	**5%**	12%**	6%	17%**	10%

*Consisted of 53 weeks.
**Excluding revenues from Diamond's and John A. Brown.

One measure we use to evaluate the productivity of our stores is revenues per square foot.

Revenues Per Square Foot* (Unaudited) (Dollars)	**1986**	1985	1984
Target	**$188**	$180	$171
Mervyn's	**$226**	$233	$226
DHDSC	**$201**	$184	$177
Lechmere	**$328**	$340	$329

*Thirteen-month average retail square feet.

Included in our revenues is finance charge revenue of $151.4 million on internal credit sales of $2.39 billion in 1986, $144.1 million on sales of $2.27 billion in 1985 and $136.3 million on sales of $2.18 billion in 1984.

Gross Margin Rate

Our overall gross margin rate (excluding buying and occupancy) declined in 1986 due primarily to a substantial reduction at Mervyn's. The decline at Mervyn's resulted from higher markdowns and an aggressive program undertaken during the year to lower everyday prices. DHDSC's gross margin rate improved significantly while the rates at Target and Lechmere declined slightly.

The 1985 overall gross margin rate was higher than 1984 due to improvement at DHDSC and Target. Mervyn's gross margin rate was approximately equal to 1984, while Lechmere reported a slight decline.

We use the last-in, first-out (LIFO) method of valuing inventories and determining cost of sales. The LIFO provision included in cost of retail sales was a charge of $37.9 million ($.20 per share) in 1986 compared to a charge of $13.5 million ($.08 per share) in 1985, and a credit of $3.8 million ($.02 per share) in 1984. The increase in the 1986 provision was due to lower markups, while the increase in 1985 was the result of higher inflation rates.

Operating Expense Rate

Our operating expense rate in 1986 improved compared with 1985, continuing a trend of improvement in each of the last five years. This stems from our continued emphasis on operating expense control. Target, Mervyn's and DHDSC improved their operating expense rates in 1986, while Lechmere's rate increased slightly due primarily to expansion into new markets. Operating expenses include buying and occupancy costs, selling, publicity and administrative expenses, depreciation, rent and taxes other than income taxes. They exclude start-up expenses.

Interest Expense

Our interest costs have risen due to higher levels of debt, which were partially offset by lower interest rates during the year. As a result of our purchase and redemption of high-interest rate debt during the year, interest rates were lower on average in 1986 compared with 1985, and we will realize future interest expense savings.

Interest expense includes interest costs incurred on debt and capital leases. This expense is reduced by the amount of interest capitalized as part of an asset's cost during a period of construction or remodeling. Interest expense is also reported net of interest income, which results from seasonal cash flows and from the temporary investment of proceeds from debt issues.

Components of Interest Expense, Net	**1986**	1985	1984
Interest on debt	**$127.7**	$95.4	$88.8
Interest on capital leases	**16.4**	16.5	16.2
Interest cost capitalized	**(6.7)**	(4.7)	(4.3)
Interest income	**(19.9)**	(7.4)	(3.0)
Net expense	**$117.5**	$99.8	$97.7

Corporate Expense

The major components of corporate expense are charitable contributions in support of our 5% giving program, expenses related to corporate headquarters and the net results of operations of our test strategies. Unusual expenses of $16.8 million relating to the strategic repositioning of our department store operations are included in the 1984 amount.

Income Taxes

The components of our provision for income taxes for the past three years are as follows:

	1986	1985	1984
Current: Federal	**$170.7**	$160.8	$167.1
State	**30.2**	30.2	31.9
	200.9	191.0	199.0
Deferred: Federal	**33.2**	39.2	7.9
State	**5.1**	7.1	1.0
	38.3	46.3	8.9
Total	**$239.2**	$237.3	$207.9

We provide deferred income taxes for income and expenses which are recognized in different years for financial and tax reporting. Our deferred tax provision is comprised of the following timing differences:

	1986	1985	1984
Excess of tax over book depreciation	**$36.6**	$32.3	$21.1
Deferred income on installment sales	**(1.1)**	14.3	(4.8)
Other	**2.8**	(.3)	(7.4)
Provision for deferred taxes	**$38.3**	$46.3	$ 8.9

Our effective income tax rate was 48.4% in 1986 and 45.8% in 1985 and 1984. The increase in our 1986 rate is primarily the result of the loss of investment tax credit under the Tax Reform Act of 1986 which reduced 1986 earnings by approximately $11 million ($ .11 per share). Our effective tax rates for 1986, 1985 and 1984 vary from the federal statutory rate as follows:

Percent of Earnings Before Income Taxes	1986	1985	1984
Statutory rate	**46.0%**	46.0%	46.0%
State income taxes, net of federal tax benefit	**3.9**	3.9	3.9
Tax credits, net*	**(2.0)**	(3.6)	(3.2)
Other	**.5**	(.5)	(.9)
Effective tax rate	**48.4%**	45.8%	45.8%

*Net tax credits, primarily investment tax credits, were $9.9 million in 1986, $18.4 million in 1985 and $14.3 million in 1984.

Assuming the Tax Reform Act remains unchanged, we anticipate our effective income tax rate will be approximately 44% in 1987 and 40% in 1988 and thereafter due to the lower statutory rates.

The 1986 Tax Reform Act repealed installment sale reporting of income from revolving credit plans effective for years beginning in 1987. The remaining deferred income from installment sales must be included in taxable income during a four-year transition period beginning in 1987. Because of this, $147.1 million of the related deferred tax credit balance has been reclassified to long-term.

In addition, tax changes related to bad debts and inventory will create new timing differences in 1987. The 1986 year-end inventory for tax purposes must be recomputed using new capitalization rules. The 1986 year-end balance of allowance for doubtful accounts and the additional inventory resulting from the new capitalization rules must be included in taxable income during the four-year transition period.

The net effect of the changes due to the Tax Reform Act will result in tax expense savings in future years. After the transition period, lower tax rates will result in decreased tax payments. The deferred tax credit balances will also be reduced from current levels. The liability method of accounting for income taxes currently proposed by the Financial Accounting Standards Board would further decrease our deferred tax balances.

Effect of Inflation

Inflation during the past three years has been minimal. As a result, reported revenue increases closely represent real growth rather than growth through increasing prices. We use the LIFO inventory accounting method for reporting purposes. We believe LIFO provides a better matching of current costs with revenues than does the first-in, first-out (FIFO) method. Consequently, the cost of goods sold included in our results of operations are already provided in real terms.

While the rate of inflation has eased, property, equipment and capital leases include the cumulative effects of both high and low inflation over the years. If these assets had been acquired at current costs, our related depreciation would have increased approximately 30% in each of the last three years.

Significant Events

- *Real Estate and Leases Acquisition.* In 1986, Target entered into an agreement covering 78 stores located primarily in California. Fifty of these stores will be remodeled and opened as Target stores. The remaining stores and lease rights will be sold. During 1987, we will incur start-up, rent and other expenses of approximately $.30 per share while the stores are closed for remodeling or held for resale. These costs will be incurred during each quarter of 1987. Costs do not include interest expense on long-term debt incurred to acquire or remodel the stores.

- *Discontinued Operations.* Effective December 27, 1986, we sold B. Dalton Bookseller. The gain on the sale (less income taxes of $31.3 million) was $85.2 million. B. Dalton had discontinued its Pickwick Discount Books test strategy in 1986. Our consolidated financial statements and related information for fiscal 1986 and prior years have been restated to reflect B. Dalton and Pickwick as discontinued operations.

Results of Discontinued Operations	1986* 47 Weeks Ended December 27, 1986	1985 52 Weeks Ended February 1, 1986	1984 53 Weeks Ended February 2, 1985
Revenues	**$514.7**	$538.1	$489.8
Earnings before income taxes	**3.6**	6.7	25.8
Income taxes	**(1.5)**	(3.6)	(12.1)
Net earnings	**$ 2.1**	$ 3.1	$ 13.7

*Results from Pickwick included through July 5, 1986.

- *Extraordinary Charge.* During 1986, we purchased and redeemed a significant portion of our high-interest rate debt at a premium above par. This purchase and redemption resulted in an extraordinary charge of $32.3 million (net of a tax benefit of $32.6 million). The replacement of the debt at lower interest rates will result in expense savings in future years.

- *Strategic Changes - Department Stores.* During 1984, strategic changes in our department store segment resulted in unusual expenses of $16.8 million ($.09 per share). The Dayton Hudson Department Store Company was formed by the combination of Dayton's and Hudson's in May 1984. In September 1984, we sold substantially all the assets of Diamond's and John A. Brown to another retailer.

Business Segment Comparisons (Millions of Dollars)	**1986**	1985	1984*	1983	1982
Revenues					
Target	**$4,354.9**	$3,931.5	$3,550.1	$3,118.4	$2,412.4
Mervyn's	**2,862.3**	2,527.0	2,141.1	1,688.9	1,335.8
Department stores	**1,566.3**	1,447.9	1,547.8	1,483.9	1,350.2
Lechmere	**475.6**	348.9	280.2	227.0	188.0
Total	**$9,259.1**	$8,255.3	$7,519.2	$6,518.2	$5,286.4
Operating profit					
Target	**$ 311.0**	$ 277.8	$ 235.6	$ 176.8	$ 150.1
Mervyn's	**160.2**	245.0	223.3	184.5	152.3
Department stores	**165.8**	121.8	106.7	155.7	114.4
Lechmere	**19.5**	19.8	20.2	18.8	12.0
Total	**656.5**	664.4	585.8	535.8	428.8
Interest expense, net	**117.5**	99.8	97.7	86.1	64.9
Corporate expense	**54.2**	57.2	47.4	40.2	10.2
Corporate and interest expense absorbed by discontinued operations	**(9.4)**	(10.4)	(12.8)	(6.4)	(4.4)
Earnings from continuing operations before income taxes and extraordinary charge	**$ 494.2**	$ 517.8	$ 453.5	$ 415.9	$ 358.1
Operating profit as a percent of revenues					
Target	**7.1%**	7.1%	6.6%	5.7%	6.2%
Mervyn's	**5.6**	9.7	10.4	10.9	11.4
Department stores	**10.6**	8.4	6.9	10.5	8.5
Lechmere	**4.1**	5.7	7.2	8.3	6.4
Assets					
Target	**$2,178.6**	$1,518.8	$1,374.9	$1,257.8	$1,056.2
Mervyn's	**1,817.4**	1,614.5	1,328.9	1,064.2	821.3
Department stores	**738.6**	737.9	727.2	863.3	819.5
Lechmere	**317.5**	209.9	151.0	105.4	89.2
Discontinued operations	**—**	221.4	204.0	185.7	152.6
Corporate	**229.9**	115.0	13.9	118.5	46.5
Total	**$5,282.0**	$4,417.5	$3,799.9	$3,594.9	$2,985.3
Depreciation					
Target	**$ 76.3**	$ 70.0	$ 65.7	$ 56.4	$ 42.1
Mervyn's	**67.5**	54.5	42.7	30.0	23.6
Department stores	**28.0**	27.3	31.9	33.0	31.2
Lechmere	**7.8**	4.5	3.1	2.0	1.8
Corporate	**3.1**	1.9	1.5	1.7	.7
	182.7	158.2	144.9	123.1	99.4
Less depreciation on capital leases	**8.1**	8.0	8.1	7.7	7.9
Total	**$ 174.6**	$ 150.2	$ 136.8	$ 115.4	$ 91.5
Capital expenditures					
Target	**$ 598.0**	$ 138.3	$ 109.8	$ 143.4	$ 137.5
Mervyn's	**243.5**	176.6	165.4	138.3	95.7
Department stores	**30.5**	36.8	33.5	26.5	27.8
Lechmere	**48.6**	42.1	24.5	5.7	2.9
Corporate	**20.3**	9.2	2.9	6.8	4.3
	940.9	403.0	336.1	320.7	268.2
Less expenditures on capital leases	**9.1**	7.9	10.5	25.6	11.9
Total	**$ 931.8**	$ 395.1	$ 325.6	$ 295.1	$ 256.3

*Consisted of 53 weeks.

Department stores include Diamond's and John A. Brown through September 29, 1984.

Business Segment Trends

As shown in the business segment comparisons on page 16, Target and Mervyn's continue to contribute the greatest portion of our revenues. These two companies have contributed 89% of our growth in revenues over the past five years.

Operating profit has increased at a compound growth rate of 15% over the last five years. Operating profit in 1986 reflects the significant reduction in Mervyn's gross margin rate. Mervyn's decline in operating profit was partially offset by a significant improvement at DHDSC and a solid increase at Target.

Quarterly Results (Unaudited)

We experienced double-digit increases in total revenues and moderate growth in comparable-store revenues during each quarter of 1986. However, net earnings from continuing operations were below last year in the second half of 1986 due to Mervyn's decline. The table below summarizes our performance by quarter for 1986 and 1985.

We follow the same accounting policies in preparing our quarterly financial data as we do in preparing our annual data, with the following modifications:

- We expense costs of opening new stores evenly throughout the year in which they are incurred.
- We recognize real estate taxes, bonuses, professional fees and benefit plan expenses throughout the year based on anticipated annual amounts.
- We accrue charitable contribution expense based on taxable income.
- We incur additional rental expense on the majority of our leased stores if the stores' annual sales exceed certain stipulated amounts. We estimate and record this additional rent each month based on actual monthly sales.
- We use our anticipated effective annual tax rate to compute income taxes on our quarterly earnings.
- During the year we forecast our annual LIFO expense based on estimates of three factors: inflation rates (based on the Department Stores Inventory Price Index published by the Bureau of Labor Statistics), inventory levels and mark-up levels. We allocate the projected expense to the quarters based on our historical experience of quarterly sales. In the fourth quarter of each year, we record the adjustment reflecting the difference between our estimates and actual LIFO expense. The following table shows the LIFO impact on earnings per share as we reported it and reallocated as if we had known the final inflation rates, inventory levels and mark-up rates when we made our quarterly accruals.

LIFO Expense (Credit)	As Reported			Reallocated		
Quarter	**1986**	1985	1984	**1986**	1985	1984
First	**$ .04**	$ .05	$ .05	**$ .04**	$ .01	$ —
Second	**.03**	.03	.02	**.04**	.02	—
Third	**.09**	.04	(.01)	**.05**	.02	(.01)
Fourth	**.04**	(.04)	(.08)	**.07**	.03	(.01)
Total Year	**$ .20**	$ .08	$(.02)	**$ .20**	$ .08	$(.02)

	First Quarter		Second Quarter		Third Quarter		Fourth Quarter		Total Year	
	1986	1985	**1986**	1985	**1986**	1985	**1986**	1985	**1986**	1985
Revenues*	**$1,886.7**	$1,710.8	**$2,041.7**	$1,850.1	**$2,215.2**	$1,955.5	**$3,115.5**	$2,738.9	**$9,259.1**	$8,255.3
Gross Profit**	**$ 547.2**	$ 486.0	**$ 559.8**	$ 514.4	**$ 617.1**	$ 552.9	**$ 829.8**	$ 793.7	**$2,553.9**	$2,347.0
Net Earnings:										
Continuing	**$ 40.5**	$ 33.8	**$ 40.6**	$ 39.4	**$ 53.1**	$ 57.2	**$ 120.8**	$ 150.1	**$ 255.0**	$ 280.5
Discontinued	**(1.9)**	(.4)	**(3.9)**	.6	**(1.1)**	(.3)	**9.0**	3.2	**2.1**	3.1
Gain on Sale of B. Dalton	**—**	—	**—**	—	**—**	—	**85.2**	—	**85.2**	—
Extraordinary Charge	**—**	—	**—**	—	**(19.7)**	—	**(12.6)**	—	**(32.3)**	—
Consolidated	**$ 38.6**	$ 33.4	**$ 36.7**	$ 40.0	**$ 32.3**	$ 56.9	**$ 202.4**	$ 153.3	**$ 310.0**	$ 283.6
Net Earnings Per Share:										
Continuing	**$ .42**	$ .34	**$ .41**	$ .42	**$ .55**	$ .58	**$ 1.24**	$ 1.55	**$ 2.62**	$ 2.89
Discontinued	**(.02)**	—	**(.04)**	—	**(.01)**	—	**.09**	.03	**.02**	.03
Gain on Sale of B. Dalton	**—**	—	**—**	—	**—**	—	**.88**	—	**.88**	—
Extraordinary Charge	**—**	—	**—**	—	**(.20)**	—	**(.13)**	—	**(.33)**	—
Consolidated	**$ .40**	$ .34	**$ .37**	$ .42	**$ .34**	$ .58	**$ 2.08**	$ 1.58	**$ 3.19**	$ 2.92

*Revenues from continuing operations.

**Gross profit is revenues less cost of retail sales, buying and occupancy.

Consolidated Results of Operations

Dayton Hudson Corporation and Subsidiaries

(Millions of Dollars, Except Per-Share Data)	1986	1985	1984*
Revenues	**$9,259.1**	$8,255.3	$7,519.2
Costs and Expenses			
Cost of retail sales, buying and occupancy	**6,705.2**	5,908.3	5,392.1
Selling, publicity and administrative	**1,538.1**	1,365.9	1,234.4
Depreciation	**182.7**	158.2	144.9
Rental expense	**73.1**	69.0	69.5
Interest expense, net	**117.5**	99.8	97.7
Taxes other than income taxes	**148.3**	136.3	127.1
	8,764.9	7,737.5	7,065.7
Earnings From Continuing Operations Before Income Taxes and Extraordinary Charge	**494.2**	517.8	453.5
Provision for Income Taxes	**239.2**	237.3	207.9
Net Earnings From Continuing Operations Before Extraordinary Charge	**255.0**	280.5	245.6
Net Earnings From Discontinued Operations			
Earnings From Operations	**2.1**	3.1	13.7
Gain on Sale of B. Dalton	**85.2**	—	—
Net Earnings Before Extraordinary Charge	**342.3**	283.6	259.3
Extraordinary Charge From Purchase and Redemption of Debt, Net of Tax Benefit	**(32.3)**	—	—
Consolidated Net Earnings	**$ 310.0**	$ 283.6	$ 259.3
Net Earnings Per Share			
Continuing Operations	**$ 2.62**	$ 2.89	$ 2.54
Discontinued Operations			
Earnings From Operations	**.02**	.03	.14
Gain on Sale of B. Dalton	**.88**	—	—
Earnings Before Extraordinary Charge	**3.52**	2.92	2.68
Extraordinary Charge	**(.33)**	—	—
Consolidated	**$ 3.19**	$ 2.92	$ 2.68

*Consisted of 53 weeks.

These financial statements should be read in conjunction with information contained on pages 14-17 and 22-24.

Consolidated Statements of Financial Position

Dayton Hudson Corporation and Subsidiaries

(Millions of Dollars)	January 31, 1987	February 1, 1986
ASSETS		
Current Assets		
Cash	**$ 64.8**	$ 83.4
Marketable securities	**159.0**	96.4
Accounts receivable (net of allowance for doubtful accounts of $29.5 and $34.6)	**1,052.5**	1,050.8
Merchandise inventories (net of accumulated LIFO provision of $179.5 and $141.6)	**1,312.5**	1,150.0
Current assets of discontinued operations	**—**	145.2
Other	**28.6**	22.8
	2,617.4	2,548.6
Property and Equipment		
Land	**328.3**	234.4
Buildings and improvements	**1,466.3**	1,204.3
Fixtures and equipment	**959.7**	821.0
Construction-in-progress	**455.5**	96.8
Accumulated depreciation	**(807.5)**	(700.8)
	2,402.3	1,655.7
Property Under Capital Leases, Net	**114.9**	114.7
Assets Held for Resale	**100.5**	—
Non-Current Assets of Discontinued Operations	**—**	76.2
Other	**46.9**	22.3
	$5,282.0	$4,417.5
LIABILITIES AND SHAREHOLDERS' INVESTMENT		
Current Liabilities		
Accounts payable (including outstanding drafts of $185.8 and $146.0)	**$ 841.9**	$ 657.0
Accrued liabilities	**429.3**	356.9
Income taxes payable	**116.8**	111.1
Current deferred income taxes	**25.9**	174.1
Current portion of capital lease obligations and long-term debt	**10.7**	24.8
Current liabilities of discontinued operations	**—**	94.5
	1,424.6	1,418.4
Capital Lease Obligations	**131.6**	128.1
Long-Term Debt	**1,244.9**	794.5
Non-Current Liabilities of Discontinued Operations	**—**	7.7
Deferred Income Taxes and Other	**301.4**	121.4
Shareholders' Investment		
Common stock	**97.4**	97.2
Additional paid-in capital	**18.4**	12.8
Retained earnings	**2,063.7**	1,837.4
	2,179.5	1,947.4
	$5,282.0	$4,417.5

These financial statements should be read in conjunction with information contained on pages 14-17 and 22-24.

Consolidated Statements of Changes in Financial Position

Dayton Hudson Corporation and Subsidiaries

(Millions of Dollars)	1986	1985	1984
Funds Provided By Operations			
Net earnings from continuing operations before extraordinary charge	**$ 255.0**	$ 280.5	$ 245.6
Depreciation and amortization	**184.9**	159.3	145.3
Deferred income taxes	**39.3**	32.0	13.6
Funds Provided by Continuing Operations	**479.2**	471.8	404.5
Discontinued Operations			
Provided by operations	**15.5**	18.9	26.1
Net gain on sale of B. Dalton	**85.2**	—	—
Extraordinary charge, net	**(32.3)**	—	—
	547.6	490.7	430.6
Investment Activities and Distribution to Shareholders			
Expenditures for property and capital leases	**602.8**	403.0	336.1
Acquisition of Target real estate and leases			
Assets to be remodeled	**338.1**	—	—
Assets held for resale	**100.5**	—	—
Disposals of property and capital leases	**(11.4)**	(7.8)	(80.4)
Increase in working capital*	**12.9**	45.5	162.8
Dividends	**83.7**	76.2	67.3
Activities of discontinued operations, net	**(62.6)**	21.7	22.8
	1,064.0	538.6	508.6
Net Financial Requirements	**$ 516.4**	$ 47.9	$ 78.0
Financing Activities			
(Increase)/decrease in cash and marketable securities	**$ (44.0)**	$ (122.0)	$ 59.3
Current maturities and retirement of long-term debt and capital lease obligations	**(11.3)**	(121.5)	(15.9)
Increase in capital lease obligations	**9.1**	7.9	10.5
Additions to long-term debt	**1,000.0**	300.0	6.9
Purchase and redemption of debt	**(558.5)**	—	—
Reclassification of deferred taxes	**147.1**	—	—
Other, net	**(26.0)**	(16.5)	17.2
Net Financing Provided	**$ 516.4**	$ 47.9	$ 78.0
***Analysis of Changes in Working Capital:**			
Accounts receivable	**$ 1.7**	$ 63.0	$ 40.4
Merchandise inventories	**162.5**	160.4	101.6
Other current assets	**5.8**	8.4	(3.0)
Accounts payable	**(184.9)**	(114.0)	(17.0)
Accrued liabilities	**(72.4)**	(51.8)	10.5
Income taxes—payable and current deferred	**142.5**	(27.1)	4.2
Working capital of discontinued operations	**(42.3)**	6.6	26.1
Increase in Working Capital	**$ 12.9**	$ 45.5	$ 162.8

These financial statements should be read in conjunction with information contained on pages 14-17 and 22-24.

Consolidated Statements of Shareholders' Investment

Dayton Hudson Corporation and Subsidiaries

(Millions of Dollars)	Total	Common Stock	Additional Paid-In Capital	Retained Earnings
Balance January 28, 1984	$1,540.2	$96.8	$ 5.4	$1,438.0
Consolidated net earnings	259.3			259.3
Dividends declared	(67.3)			(67.3)
Stock option activity	4.3	0.2	4.1	
Balance February 2, 1985	1,736.5	97.0	9.5	1,630.0
Consolidated net earnings	283.6			283.6
Dividends declared	(76.2)			(76.2)
Stock option activity	3.5	0.2	3.3	
Balance February 1, 1986	1,947.4	97.2	12.8	1,837.4
Consolidated net earnings	310.0			310.0
Dividends declared	(83.7)			(83.7)
Stock option activity	5.8	0.2	5.6	
Balance January 31, 1987	$2,179.5	$97.4	$18.4	$2,063.7

Preferred Stock
Authorized 5,000,000 shares, voting, $.01 par value; no shares outstanding at January 31, 1987 and February 1, 1986.

Common Stock
Authorized 500,000,000 shares $1 par value; 97,368,703 shares issued and outstanding at January 31, 1987; 97,196,263 shares issued and outstanding at February 1, 1986.

Junior Preferred Stock Rights
In September 1986, we declared a distribution of preferred share purchase rights. Terms of the plan provide for a distribution of one preferred share purchase right on each outstanding share of Dayton Hudson common stock. Each right will entitle shareholders to buy one-hundredth of a share of a new series of junior participating preferred stock at an exercise price of $150, subject to adjustment. The rights will be exercisable only if a person or group acquires ownership of 20% or more of Dayton Hudson common stock or announces a tender offer to acquire 30% or more of the common stock.

These financial statements should be read in conjunction with information contained on pages 14-17 and 22-24.

Summary of Accounting Policies

Consolidation. Our financial statements include the accounts of Dayton Hudson Corporation and subsidiaries after elimination of material intercompany balances and transactions. All subsidiaries are wholly owned.

Marketable Securities. We record short-term investments at cost, which approximates market.

Sales and Accounts Receivable. Our policy generally is to write off accounts receivable when any portion of the balance is 12 months past due, or when the required payments have not been received for six consecutive months. We base our allowance for doubtful accounts receivable on our past bad debt experience and on the ages of the various accounts.

All customer receivables are classified as current assets, including some which are due after one year. This is consistent with practice in the retail industry.

For financial reporting, we recognize the gross profit on retail installment sales when the sales are recorded. For income tax purposes, we used the installment method of reporting profit on these sales.

Inventories. Inventories and the related cost of sales are accounted for by the retail inventory method using the last-in, first-out (LIFO) basis.

Property and Equipment. Property and equipment is recorded at cost less accumulated depreciation. For financial reporting, we compute depreciation on our property using the straight-line method over estimated useful lives. For tax purposes, we use accelerated depreciation methods.

Investment Tax Credit. The investment tax credit reduces income taxes in the year we begin using the related property.

Per-Share Data. To compute net earnings per share we divide net earnings by the weighted average number of common shares outstanding. Performance shares and the exercise of stock options would not materially dilute earnings per share.

Fiscal Year. Our fiscal year ends on the Saturday nearest January 31:

Fiscal Year	Ended	Weeks
1986	January 31, 1987	52
1985	February 1, 1986	52
1984	February 2, 1985	53

Unless otherwise stated, references to years in this report relate to fiscal years rather than to calendar years.

Debt and Leases

(Millions of Dollars)

Lines of Credit

We had no commercial paper or short-term notes payable outstanding at January 31, 1987. During the year, the average amount of commercial paper and notes payable outstanding was $55.8 million, at a weighted average interest rate of 5.9%. We maintained $68.5 million of unsecured lines of credit with nine banks. Borrowings under these lines are at the prime interest rate or at other rates agreed upon at the time of the borrowings. We compensate the banks for the lines of credit through the payment of fees. During 1986, our line agreements required us to pay fees of $0.2 million. We were not required to maintain any compensating balances under any of the agreements during 1986.

At year-end we also had additional credit available in the form of two annually renewable, three-year revolving credit agreements: one for $185 million with nine lending institutions and one for $65 million with four lending institutions. In addition, we had a two-year revolving credit agreement for $200 million with one lending institution. We cancelled this facility subsequent to year-end. We pay a fee for the availability of the revolving-credit agreements and have the option of borrowing at the prime rate or other negotiated rates. During 1986, we paid fees of $0.9 million under these agreements. Any balance outstanding under the remaining agreements at the end of the three-year period may be converted at our option into a four-year term loan. There were no balances outstanding at January 31, 1987.

We maintained additional unsecured bank lines of credit of $78 million to meet seasonal working capital needs between September 15 and December 15 in each year.

Long-Term Debt

The composition and level of long-term debt changed significantly during 1986. We issued $1 billion of debt. We also purchased and redeemed $558.5 million of our high-interest rate debt, of which $14.2 million had been classified as current. This purchase and redemption will result in future interest expense savings. The net proceeds of these transactions are being used for capital expansion, remodeling and the acquisition of real estate and other assets. At year-end 1986 and 1985, long-term debt due beyond one year was:

	Jan. 31, 1987	Feb. 1, 1986
7¾% to 14¾% Notes and Sinking Fund Debentures purchased and redeemed during 1986	**$ —**	$544.3
9¼% to 9½% Sinking Fund Debentures due 2016	**450.0**	—
7½% to 9¼% Unsecured Notes and Debentures due 1992 to 2006	**550.0**	—
8⅜% to 14¾% Other Sinking Fund Notes and Debentures due 1999 to 2015	**132.0**	135.2
7¾% to 13¼% Other Unsecured Notes due 1990 to 2014	**86.5**	86.9
6½% to 14% Notes and Contracts for purchase of real estate due 1992 to 2010	**26.4**	28.1
Total	**$1,244.9**	$794.5

The sinking fund and principal payments on this long-term debt over the next five years will be $5.6 million in 1987, $9.7 million in 1988, $9.7 million in 1989, $10.4 million in 1990 and $8.4 million in 1991.

Current Year Issues. During 1986, we issued $250 million of 9¼% sinking fund debentures and $200 million of 9½% sinking fund debentures due 2016. We also issued $100 million each of 7½% notes due 1992, 7⅞% notes due 1996, 8¼% notes due 1993, 9¼% debentures due 2006 and $150 million of 8⅜% notes due 1996.

Covenants and Collateral. In most of our long-term debt agreements, as well as the revolving credit agreements, we have agreed to observe certain covenants at the request of the lenders. Among these are provisions related to working capital, funded debt, dividends and secured debt. Under the most restrictive of these provisions, $1.38 billion of our retained earnings at the end of 1986 was available for dividends and other types of restricted payments.

As a condition of borrowing under our mortgage notes and contracts, we have pledged related land, buildings and equipment as collateral. At year end, approximately $33.6 million of our property and equipment served as collateral for these loans.

Leases

For financial reporting, we classify leases as either operating or capital leases. Capital leases are recorded as assets in our Statements of Financial Position and we report interest and depreciation expense on the leases instead of rent expense. Operating leases are not capitalized and lease rentals are expensed. For tax purposes, we deduct rent expense on all leases.

Many of our longer-term leases include options to renew, with renewal terms varying from five to thirty years. Certain leases also include options to purchase the property. In addition, we have capital leases on equipment with remaining terms ranging from one to four years.

The detail of leased property and equipment which we have capitalized in our Statements of Financial Position is:

	Jan. 31, 1987	Feb. 1, 1986
Land and buildings	**$162.1**	$154.6
Equipment	**12.0**	19.0
Accumulated depreciation	**(59.2)**	(58.9)
Net	**$114.9**	$114.7

If we were to capitalize the minimum lease payments for all of our operating leases with initial terms of over one year, the present value of these payments would be approximately $382.2 million at January 31, 1987, and $258.1 million at February 1, 1986. These present values were calculated using an average interest rate for each lease based on the year of inception. The weighted average interest rate used to calculate the 1986 present value was 12% compared with 13% for 1985.

The impact of recording depreciation and interest expense rather than rent expense on the capital leases has been to decrease our net earnings by $1.7 million in 1986, $1.8 million in 1985, and $1.7 million in 1984. Capital lease depreciation expense was $8.1 million in 1986, $8.0 million in 1985, and $8.1 million in 1984.

Rent expense includes percentage rents which are based on a percentage of sales over stated levels. Executory costs, that are included in our rental payment or charged in addition to rent, are excluded from rent expense and are included in Occupancy Costs in our Results of Operations.

Composition of Rental Expense	**1986**	1985	1984
Minimum rents on long-term operating leases	**$51.9**	$46.3	$43.9
Short-term rentals	**9.3**	9.4	11.4
Percentage rents:			
Operating leases	**13.9**	14.6	14.6
Capital leases	**1.3**	1.2	1.5
Sublease income	**(1.7)**	(1.0)	(.5)
Executory costs	**(1.6)**	(1.5)	(1.4)
Net expense	**$73.1**	$69.0	$69.5

Future minimum lease payments which must be made under noncancellable lease agreements existing at the end of 1986 are:

	Operating Leases	**Capital Leases**
1987	$ 63.6	$ 22.0
1988	61.1	20.9
1989	57.9	20.3
1990	56.4	20.3
1991	55.0	19.8
After 1991	547.4	257.3
Total minimum lease payments (a)	$841.4	$360.6
Less: Interest		213.6
Executory costs		10.3
Capitalized lease obligations, including current portion of $5.1		$136.7

(a) Minimum rental payments have not been reduced by minimum sublease rentals due in the future under noncancellable subleases ($7.7 million for operating leases, $11.8 million for capital leases).

Commitments and Contingencies

Commitments for the purchase of real estate, construction of new facilities and remodeling amounted to approximately $122.0 million at January 31, 1987. We had additional commitments of $64.0 million for equipment purchases.

Our contingent liability for mortgage debt on certain office properties sold in 1976 and certain shopping centers sold in 1978 was approximately $37.0 million at January 31, 1987. The purchasers have agreed to indemnify us for any costs we might incur in relation to the mortgages.

Our business brings us into regular contact with the general public, other businesses and governmental entities. This contact subjects us to claims and litigation arising out of the ordinary course of business. Considering the insurance coverage in place for a portion of the claims and litigation, and noting that the ultimate consequences cannot be accurately predicted, management and legal counsel believe that presently identified claims and litigation will not have a material adverse effect on our operations or financial condition.

Retirement and Stock Purchase Plans

(Millions of Dollars)

Pension Plans

We have three defined benefit pension plans which cover all employees who meet certain requirements of age, length of service and hours worked per year. The benefits provided are based upon years of service and the employee's compensation during the last five years of employment.

Contributions to the pension plans, which are made solely by the Corporation, are determined by our outside actuarial firm. To compute net pension cost, our actuarial firm estimates the total benefits which will ultimately be paid to eligible employees and then allocates these costs to service periods. Assumptions are made on the years the employees will work, their future salary increases, the number of employees who will earn the right to receive benefits under the plans, the rate at which to discount future pension benefits and the rate of return which will be earned on the plans' present assets and future contributions.

During 1985, we changed our method of accounting for pension costs to comply with the Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions." This Statement requires employers with defined benefit pension plans to calculate pension costs using the unit credit actuarial method, which we adopted in 1983. Service cost under the unit credit method is computed by determining the increase in future pension benefits resulting from the current year's service and discounting these future cash flows to the present. The projected benefit obligation is the actuarial present value of all future benefit payments for services rendered to date, including an assumption for future compensation levels.

The period over which to amortize unrecognized pension costs and credits, including prior service costs (we have none) and actuarial gains and losses is based on the remaining service period for those employees expected to receive pension benefits. Actuarial gains and losses result when actual experience differs from that assumed or when actuarial assumptions are changed.

The following tables reflect consolidated pension amounts (including immaterial amounts related to discontinued operations).

Components of Net Pension Credit	1986	1985
Service cost-benefits earned during the period	$ 9.0	$ 8.6
Interest cost on projected benefit obligation	17.5	16.6
Return on assets–actual	(39.1)	(44.9)
–deferred	17.5	24.3
Amortization of transitional asset	(8.0)	(7.9)
Net pension credit*	$ (3.1)	$ (3.3)

*These net pension credits compare to a net pension cost of $7.4 million in 1984.

Funded Status	December 31, 1986	1985
Actuarial present value of:		
Vested benefit obligation	$183.0	$152.9
Accumulated benefit obligation	$193.2	$161.1
Projected benefit obligation	$221.3	$184.3
Fair market value of plan assets*	276.1	247.0
Plan assets in excess of projected benefit obligation	54.8	62.7
Less:		
Unrecognized net actuarial gain	15.8	24.8
Unrecognized transitional asset	39.0	47.0
Accrued pension cost	$ —	$ (9.1)

*Plan assets consist primarily of equity securities, fixed income securities and insurance contracts.

Actuarial Assumptions	December 31, 1986	1985	1984
Discount rate	8.5%	9.5%	7.5%
Expected long-term rate of return on plan assets	9.5	9.5	7.5
Average assumed rate of compensation increase	6.9	6.9	6.7

Postretirement Health Care Benefits

In addition to providing pension and other supplemental benefits, we provide certain health care benefits for our retired employees. Employees become eligible for these benefits if they meet minimum age and service requirements, are eligible for retirement benefits and agree to contribute a portion of the cost. We have the right to modify these benefits. The cost of providing these retiree health care benefits is recognized as expense when claims are paid. These costs approximated $1.7 million, $1.7 million and $1.6 million for 1986, 1985 and 1984, respectively.

Stock Options and Performance Shares

We have two stock option plans for key employees. Grants have included stock options, performance shares or both. The options have included Incentive Stock Options, Non-Qualified Stock Options, or a combination of both. Twelve months after the grant date, 25% of any options granted become exercisable with another 25% after each succeeding 12 months. The options are cumulatively exercisable and expire no later than 10 years after the date of the grant. The performance shares pay cash and stock if certain selected performance goals are met at the end of a four-year period.

We record compensation expense on performance shares based on current market price of our common stock and the extent to which the performance goals are being met. We recorded expense of $0.9 million, $1.4 million and $1.2 million in 1986, 1985 and 1984, respectively. When employees exercise options, the total option price is credited to Common Stock and Additional Paid-in Capital, and no expense is incurred.

The number of shares of unissued common stock reserved for future grants under all the plans was 4,569,142 at the end of 1986 and 1,265,347 at the end of 1985.

Options and Performance Shares Outstanding	Options: Number of Shares	Price Per Share	Shares Exercisable	Performance Shares
1984				
Beginning of year	1,304,825	$ 1.99-$37.34	611,913	177,682
Granted	214,451	32.63- 36.13		
Cancelled	(83,015)	12.36- 36.44		
Exercised	(198,096)	1.99- 35.94		
1985				
Beginning of year	1,238,165	4.52- 37.34	689,192	134,109
Granted	340,761	39.94		
Cancelled	(34,121)	14.30- 39.94		
Exercised	(186,656)	4.52- 37.34		
1986				
Beginning of year	1,358,149	7.13- 39.94	698,955	100,714
Granted	121,361	53.19		
Cancelled	(53,333)	17.44- 53.19		
Exercised	(167,492)	7.13- 39.94		
End of year	1,258,685	$ 8.70-$53.19	767,640	85,411

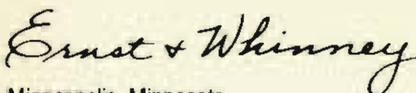
Auditors' Report

Report of Ernst & Whinney, Independent Auditors

Board of Directors and Shareholders
Dayton Hudson Corporation
Minneapolis, Minnesota

We have examined the consolidated statements of financial position of Dayton Hudson Corporation and subsidiaries as of January 31, 1987 and February 1, 1986, and the related consolidated statements of results of operations, changes in financial position and shareholders' investment for each of the three years in the period ended January 31, 1987. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of Dayton Hudson Corporation and subsidiaries at January 31, 1987 and February 1, 1986, and the consolidated results of their operations and changes in their financial position for each of the three years in the period ended January 31, 1987, in conformity with generally accepted accounting principles applied on a consistent basis.



Minneapolis, Minnesota
March 20, 1987

Report of Management

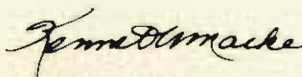
Responsibility for Financial Statements and Accounting Controls

The financial statements and other information presented in this report have been prepared in accordance with generally accepted accounting principles. Management is responsible for the consistency, integrity and presentation of the information in the Annual Report, which necessarily includes some amounts based upon our judgments and best estimates.

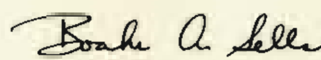
To discharge this responsibility, we maintain a comprehensive system of internal controls designed to provide reasonable assurance that assets are safeguarded and transactions are executed in accordance with established procedures. The concept of reasonable assurance is based upon a recognition that the cost of the controls should not exceed the benefit derived. After judging the cost and benefit factors, we believe our system of internal controls provides this reasonable assurance.

The Audit Committee of the Board of Directors, consisting of five outside directors, recommends independent auditors for appointment by the Board and reviews their proposed services and their reports. The Audit Committee also reviews the internal audit plan and their audit reports. Our independent auditors, Ernst & Whinney, our internal auditors and our corporate controller have full and free access to the Audit Committee and meet with it periodically, with and without the presence of management. The results of the auditors' examinations and their opinions on the adequacy of our internal controls and the quality of our financial reporting are regularly reviewed by the Audit Committee.

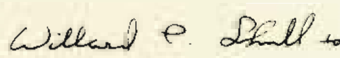
Our financial statements have been examined by Ernst & Whinney, whose report appears on this page. Their report expresses an opinion as to the fair presentation of the financial statements and is based on an independent examination made in accordance with generally accepted auditing standards.



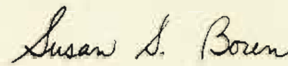
Kenneth A. Macke
Chairman of the Board and
Chief Executive Officer



Boake A. Sells
President and Chief
Operating Officer



Willard C. Shull, III
Senior Vice President,
Finance



Susan S. Boren
Vice President, Control

Financial Comparisons

Dayton Hudson Corporation and Subsidiaries

(Millions of Dollars, Except Per-Share Data)	1986	1985	1984 (a)	1983
Revenues	**$9,259.1**	8,255.3	7,519.2	6,518.2
Cost of retail sales, buying and occupancy	**$6,705.2**	5,908.3	5,392.1	4,642.5
Selling, publicity and administrative	**$1,538.1**	1,365.9	1,234.4	1,080.5
Depreciation	**$ 182.7**	158.2	144.9	123.1
Interest expense, net	**$ 117.5**	99.8	97.7	86.1
Earnings From Continuing Operations Before Income Taxes and Extraordinary Charge	**$ 494.2**	517.8	453.5	415.9
Income Taxes	**$ 239.2**	237.3	207.9	189.1
Net Earnings				
Continuing	**$ 255.0**	280.5	245.6	226.8
Discontinued (b)	**$ 87.3**(c)	3.1	13.7	18.7
Extraordinary charge	**$ (32.3)**	—	—	—
Consolidated	**$ 310.0**	283.6	259.3	245.5
Per Common Share				
Net earnings				
Continuing	**$ 2.62**	2.89	2.54	2.35
Discontinued (b)	**$ .90**(c)	.03	.14	.19
Extraordinary Charge	**$ (.33)**	—	—	—
Consolidated	**$ 3.19**	2.92	2.68	2.54
Cash dividend declared	**$ .86**	.785	.695	.625
Shareholders' investment	**$ 22.38**	20.04	17.90	15.91
Return on Beginning Equity (Shareholders' Investment)				
Continuing	**13.1%**	16.2	15.9	16.8
Consolidated	**15.9%**	16.3	16.8	18.2
Capital Expenditures	**$ 940.9**	403.0	336.1	320.7
Consolidated Year-End Financial Position				
Working capital	**$1,192.8**	1,130.2	972.8	868.6
Property and equipment, net	**$2,402.3**	1,655.7	1,418.6	1,306.8
Property under capital leases, net	**$ 114.9**	114.7	114.7	115.8
Total assets	**$5,282.0**	4,417.5	3,799.9	3,594.9
Long-term capital lease obligations	**$ 131.6**	128.1	125.2	123.9
Long-term debt	**$1,244.9**	794.5	625.4	626.8
Shareholders' investment	**$2,179.5**	1,947.4	1,736.5	1,540.2
Average Common Shares Outstanding (Millions)	**97.3**	97.1	96.9	96.6

The Financial Comparisons should be read in conjunction with the Financial Statements.

Per-share amounts and shares outstanding reflect two-for-one common stock splits effective July 1983 and November 1981.

(a) Consisted of 53 weeks.
(b) Discontinued operations include discontinued real estate through 1981 and B. Dalton Bookseller for all years.
(c) Includes the gain on sale of B. Dalton Bookseller.

1982	1981	1980	1979	1978 (a)	1977	1976
5,286.4	4,623.6	3,777.9	3,174.9	2,787.5	2,356.7	2,018.9
3,721.7	3,278.3	2,678.7	2,218.1	1,943.7	1,643.8	1,412.1
901.8	826.9	690.1	590.4	508.5	417.9	358.9
99.4	85.1	62.4	46.8	37.5	34.1	29.2
64.9	47.1	13.6	5.4	14.2	15.1	13.2
358.1	261.2	230.0	223.0	183.7	173.7	144.6
165.6	116.2	103.1	106.8	95.1	88.8	74.7
192.5	145.0	126.9	116.2	88.6	84.9	69.9
14.2	28.4	19.8	75.9	176.3	13.0	7.1
—	—	—	—	—	—	—
206.7	173.4	146.7	192.1	264.9	97.9	77.0
2.00	1.51	1.33	1.23	.93	.91	.75
.15	.30	.21	.80	1.87	.13	.07
—	—	—	—	—	—	—
2.15	1.81	1.54	2.03	2.80	1.04	.82
.575	.525	.475	.425	.375	.325	.26
13.98	12.41	11.14	10.09	8.50	6.10	5.28
16.1	13.6	13.2	14.4	15.3	17.0	16.0
17.3	16.3	15.2	23.8	45.7	19.6	17.7
268.2	238.1	247.2	201.8	147.9	100.4	71.8
718.3	508.9	381.3	438.8	427.6	309.4	288.2
1,139.0	978.1	826.7	596.3	451.0	363.6	303.2
97.9	93.9	100.4	67.2	70.9	57.0	52.2
2,985.3	2,555.2	2,155.2	1,793.2	1,637.5	1,411.4	1,213.1
102.4	96.3	103.3	73.0	76.8	62.0	56.6
529.3	331.8	213.8	117.6	94.3	116.8	111.7
1,348.8	1,192.7	1,066.4	962.6	808.4	579.8	499.2
96.2	95.8	95.2	94.8	94.4	94.0	93.3

Stores and Locations

TARGET	No. of Stores	Retail Sq. Ft. (000)
Arizona	10	1,034
Arkansas	3	289
California	37	3,789
Colorado	16	1,658
Illinois	5	407
Indiana	31	2,583
Iowa	15	1,247
Kansas	2	200
Kentucky	5	427
Louisiana	2	202
Minnesota	20	2,254
Missouri	11	1,137
Montana	2	182
Nebraska	4	406
North Dakota	4	364
Ohio	1	79
Oklahoma	7	702
South Dakota	2	201
Tennessee	9	886
Texas	48	4,922
Wisconsin	10	1,109
Wyoming	2	182
	246	24,260

Major Markets	No. of Stores
Los Angeles	30
Minneapolis/St. Paul	17
Houston	16
Dallas/Ft. Worth	13
Denver	11
Indianapolis	9

MERVYN'S	No. of Stores	Retail Sq. Ft. (000)
Arizona	11	906
California	87	6,687
Colorado	7	544
Georgia	5	400
Louisiana	6	455
Nevada	5	346
New Mexico	2	180
Oklahoma	3	270
Oregon	5	423
Texas	33	2,630
Utah	6	530
Washington	5	468
	175	13,839

Major Markets	No. of Stores
Los Angeles	32
San Francisco	19
Dallas/Ft. Worth	10
Houston	9
San Diego	7
Phoenix	6

DAYTON HUDSON DEPARTMENT STORE COMPANY	No. of Stores	Retail Sq. Ft. (000)
HUDSON'S		
Indiana	2	246
Michigan	17	4,180
Ohio	1	187
	20	4,613
DAYTON'S		
Minnesota	12	2,676
North Dakota	3	299
South Dakota	1	102
Wisconsin	1	101
	17	3,178
Total	37	7,791

Major Markets	No. of Stores
Minneapolis/St. Paul	10
Detroit	8

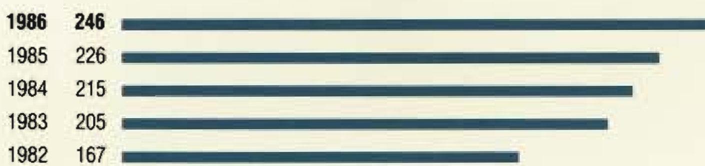
LECHMERE	No. of Stores	Retail Sq. Ft. (000)
Connecticut	1	77
Georgia	4	348
Massachusetts	7	869
New Hampshire	2	204
New York	1	105
Rhode Island	2	179
	17	1,782

Major Markets	No. of Stores
Boston	6
Atlanta	4

Total All Stores	475
Total Retail Square Feet	47,672

TARGET

- 1-5
- 6-15
- 16-25
- 26-50

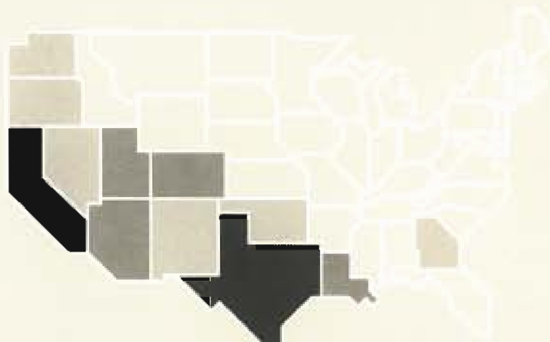


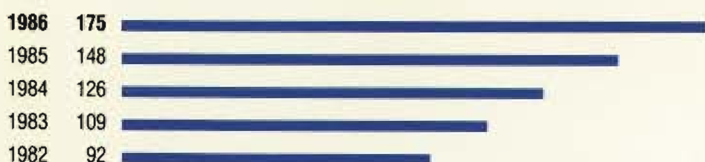
DAYTON HUDSON DEPARTMENT STORE COMPANY

- 1-5
- 6-15
- 16-25

MERVYN'S

- 1-5
- 6-15
- 16-25
- 26-50
- 51-90





LECHMERE

- 1-5
- 6-15

Directors and Management

Directors

Rand V. Araskog,
Chairman of the Board and
Chief Executive Officer, ITT
Corporation (diversified
multinational company) (1)(2)(3)(5)

Robert A. Burnett,
President and Chief Executive
Officer, Meredith Corporation
(media company engaged in
printing, publishing, broadcasting
and real estate) (1)(2)(3)

Roger L. Hale,
President and Chief Executive
Officer, Tennant Company
(industrial equipment manufacturer)
(1)(3)(5)

Donald J. Hall,
Chairman of the Board,
Hallmark Cards, Incorporated
(greeting card manufacturer)
(1)(2)(3)

Betty Ruth Hollander,
Chairman of the Board and
Chief Executive Officer,
The Omega Group, Inc.
(manufacturer of scientific
measurement and control
devices and systems,
technical publishing and
industrial and commercial real
estate development)
(1)(4)(5)

David T. Kearns,
Chairman of the Board and
Chief Executive Officer,
Xerox Corporation
(business products and
systems, and financial
service business) (1)

Howard H. Kehrl,
Retired Vice Chairman,
General Motors Corporation
(manufacturer of transportation
equipment) (1)(3)(5)

Kenneth A. Macke,
Chairman of the Board and
Chief Executive Officer (1)

Bruce K. MacLaury,
President, The Brookings
Institution (research and
education organization) (1)(4)(5)

David T. McLaughlin,
President, Dartmouth College
(1)(4)(5)

John A. Rollwagen,
Chairman of the Board and
Chief Executive Officer,
Cray Research, Inc.
(manufacturer of super computers)
(1)(2)(4)

Boake A. Sells,
President and Chief Operating
Officer

Shirley Young,
President, Grey Strategic
Marketing, Inc. (subsidiary
of Grey Advertising, Inc.,
national advertising agency)
(1)(2)(4)

(1) Executive Committee
(2) Audit Committee
(3) Compensation Committee
(4) Corporate Responsibility Committee
(5) Finance Committee

Officers

Kenneth A. Macke,*
Chairman of the Board and
Chief Executive Officer

Boake A. Sells,*
President and Chief
Operating Officer

Gerald R. Gallagher,
Vice Chairman to June 30, 1987

Bruce G. Allbright,*
Senior Vice President

James T. Hale,*
Senior Vice President and
Secretary

Willard C. Shull, III,*
Senior Vice President

Edwin H. Wingate,*
Senior Vice President

Ann H. Barkelew,*
Vice President

Susan S. Boren,*
Vice President

Larry E. Carlson,
Vice President

Karol D. Emmerich,
Vice President and Treasurer

L. Fred Hamacher,
Vice President

William E. Harder,
Vice President and
Assistant Secretary

Peter C. Hutchinson,*
Vice President

Kathy Barnes Probelski,
Vice President

James R. Eckmann,
Assistant Treasurer

William P. Hise,
Assistant Secretary

Operating Company Management

Target
Bruce G. Allbright,*
Chairman and
Chief Executive Officer

Robert J. Ulrich,
President and Chief
Operating Officer

Mervyn's
Walter T. Rossi,*
President and
Chief Executive Officer

Dayton Hudson Department Store Company
Stephen E. Watson,*
Chairman and
Chief Executive Officer

Raj Joneja,
President

Lechmere
C. George Scala,
Chairman, President and
Chief Executive Officer

*Executive Officers

DAYTON HUDSON CORPORATION

777 Nicollet Mall
Minneapolis, Minnesota 55402